

VZCZCXRO3246
RR RUEHDBU RUEHLN RUEHSK RUEHVK RUEHYG
DE RUEHYE #0225/01 0890325
ZNR UUUUU ZZH
R 300325Z MAR 09
FM AMEMBASSY YEREVAN
TO RUEHC/SECSTATE WASHDC 8879
INFO RUCPDO/USDOC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC 0631
RUCNCIS/CIS COLLECTIVE
RUEHAK/AMEMBASSY ANKARA 1713
RUEHIT/AMCONSUL ISTANBUL 0733
RHEHNSC/NSC WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORPORATION WASHINGTON DC

UNCLAS SECTION 01 OF 04 YEREVAN 000225

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: [ECON](#) [EFIN](#) [ETRD](#) [AM](#)
SUBJECT: ARMENIA - MACROECONOMIC OVERVIEW FOR 2008

YEREVAN 00000225 001.2 OF 004

SUMMARY

1. (SBU) Armenia's economic growth slowed considerably in 2008, with signs of global financial crisis observed in nearly all sectors of the economy. Construction, the main driver of the country's double-digit economic growth in recent years, was among the hardest hit. Mining and metallurgy sectors, Armenia's leading exports, suffered from the collapse in world prices. The growth of remittances also decreased as the Russian economy declined with the fall in world oil prices. The banking sector was relatively stable, though there is high risk of re-dollarization of the economy. Armenia will feel the full impact of the global crisis Armenia in 2009, with expectations of negative GDP growth. End Summary.

ECONOMIC GROWTH RATE SLOWED DOWN

2. (SBU) After six consecutive years of double-digit expansion, Armenia's GDP growth declined to 6.8 percent in 2008, compared to 13.7 percent in 2007. According to Armenia's National Statistical Service (NSS), the GDP growth rate began to decelerate sharply in October 2008, when it declined by 8.3 percent from September and shrank by another 30.7 percent in November compared to October. However, official GOAM statistics show a 23.7 percent growth in December compared to November (which brought the cumulative January-to-December growth rate to 6.8 percent year-on-year), with almost all sectors, including agriculture, industry, electricity production, trade and services reporting positive value-added growth. (NOTE: There is a possibility that the NSS has manipulated the December figures for a number of economic indicators in order to give the appearance of overall positive growth for the year. END NOTE.) In nominal terms GDP was equal to around 3,650 billion drams (USD 11.9 billion), and GDP per capita was equal to USD 3,689. The World Bank projects zero percent GDP growth in 2009, while the IMF and the GOAM itself project a contraction of 1.5 percent.

3. (SBU) The industrial sector grew two percent in 2008, though with an 11.4 percent decline in November. Factoring out electricity, gas and water production from these figures, the industrial sector grew on average by 0.8 percent year-on-year and contributed 0.4 percentage points to GDP growth, while comprising 13 percent of GDP (compared to 15 percent in 2007). The mining industry grew by 1.5 percent, manufacturing by 0.6 percent, and electricity production and distribution by 7.2 percent. The food processing output growth rate remained high at seven percent, while metallurgy, the second largest manufacturing sector after food processing, contracted by 9.6 percent (compared to 13.8 percent growth in 2007), due to falling international prices.

14. (SBU) Chemical production decreased by 14.8 percent, compared to 19.2 percent growth in 2007. As of February 2009, most of the mining and metallurgy companies in Armenia have suffered losses or significant revenue declines due to falling world prices for base metals. Several mining companies have already closed down or have drastically scaled back their operations.

15. (SBU) The construction sector, which was the main driver of economic growth during the six years of Armenia's double-digit GDP growth, grew by only 1.7 percent in 2008 (compared to 19.7 percent growth in 2007), contributing 1.8 percentage points to the GDP growth rate. While the growth rate of construction output had been slower throughout the year, it declined by 41 percent in October (compared to October 2007) and 9.4 percent in November. However, NSS statistics show an amazing 18.1 percent growth in construction output in December compared to November, which kept the average growth rate for the year from turning negative. Almost all construction projects in Yerevan have either been put on hold or cancelled, leaving a large number of half-completed buildings in downtown Yerevan. Through a combination of reduced bank lending, interest rates of up to 20 percent, and a decline in remittance flows, the real estate market is also down, with almost no demand for expensive housing in the recently built "elite" apartment buildings. According to Ministry of Finance estimates, construction is expected to decline by around 3 percent in 2009.

16. (SBU) The agricultural sector, comprising 15.7 percent of overall GDP, reported 1.3 percent growth in 2008, down from 9.6 percent growth in 2007. After an almost 50 percent drop in November compared to October, the sector reported a 15.1 percent growth in December, which can be partly attributed to higher production volumes in meat products for the holiday season. The services sector posted 13.8 percent growth in 2008, accounting for 34.3 percent of GDP. Communication services reported 14.9 percent growth, while the volume of freight forwarded declined by 8.8 percent.

17. (SBU) Armenian commercial banks were stable in 2008, as the

YEREVAN 00000225 002.2 OF 004

banking sector is not tightly integrated into world financial markets, and the Central Bank exercised strong oversight. Overall, the financial services sector posted 23.5 percent growth in 2008 and Armenian banks earned USD 85 million in profits. Outstanding loans reached USD 2 billion as of the end of 2008, around a 50 percent increase compared to 2007. Total bank deposits as of December 31, 2008 were up 13 percent over the prior year. However, there was some movement out of AMD and into USD, likely due to expectations of a devaluation of the AMD: AMD deposits decreased by AMD 227.5 billion--about seven percent--while dollar deposits increased by AMD 238.5 billion (41 percent). Banks have tightened lending procedures, and interest rates on both loans and deposits increased; for consumer loans reaching 16-24 percent, depending on maturity, and for mortgages 17-18 percent. One year AMD deposit rates reached 11 percent.

SLOWDOWN IN REMITTANCES

18. (SBU) Armenians working abroad sent approximately USD 1.6 billion through bank transfers in 2008, according to CBA data, a 24 percent increase over 2007 (a comparable amount flows in through non-bank channels). While the volume of remittances increased in absolute terms, the growth rate decreased considerably compared to the previous year (growth in 2007 was 37 percent). The Ministry of Finance estimates remittances will increase only by 1.3 percent in 2009, while others project an absolute decline. Remittances constitute approximately 15 percent of Armenia's GDP, and support not only subsistence consumption but also help finance much of the country's construction activity.

19. (SBU) Eighty percent of Armenia's remittances have come from Russia in recent years. The inflow of those remittances, usually dollar-denominated, was one of the factors behind the appreciation of the AMD over the past three years.

DRAM SUPPORTED BY CENTRAL BANK

110. (SBU) After almost five years of steady appreciation, the Armenian Dram remained relatively stable in 2008, despite the

decline of remittances and considerable reduction of export volumes.

In an effort to stabilize the AMD and prevent a loss of depositor confidence, the CBA sold 442.6 million (and also bought USD 74.6 million) in 2008. Much of this occurred in the fourth quarter, when the CBA sold USD 303.6 million and bought USD 12.6 million. (Note: On March 3, 2009, the CBA announced it would stop supporting the AMD, prompting a one-day fall to approximately AMD 370 per USD. It has traded in that range since. End Note).

¶11. (SBU) According to the CBA, Armenia's gross foreign reserves as of the end of December 2008 stood at USD 1.4 billion, sufficient to finance less than 4 months of imports. However, after netting out Armenia's debt to the IMF, and reserve requirements posted by banks, net foreign reserves were equal to around USD 800 million, roughly 2.4 months of imports.

UNEMPLOYMENT AND WAGES

¶12. (SBU) The official unemployment rate, which includes jobless persons registered with the State Employment Service, was 6.3 percent (74.9 thousand persons) in 2008, down from 7.1 percent in 2007, according to the NSS (Note: Household surveys generally show the unofficial unemployment rate at about 28-30 percent, excluding those working abroad). The unemployment rate for women, which has traditionally been higher than for men, was 9.4 percent, down from 10.2 percent in 2007. Women constitute 75 percent of the total unemployed. The unemployment rate is expected to jump considerably in 2009 as the impact of the global economic crisis on the Armenian economy deepens. According to the State Employment Service, as of January 2009 3,000 persons have lost jobs or have already received contract termination notices. Several large mining companies have slashed jobs, closed down or cut output volumes.

¶13. (SBU) Layoffs in Russia due to the economic crisis, together with a reduction of official quotas for work permits to foreigners by the Russian authorities, are expected to result in thousands of seasonal workers returning to Armenia, contributing to potential social tension. According State Employment Service estimates, 55,000 returned migrant workers do not intend to leave abroad for seasonal work this year.

¶14. (SBU) Average monthly nominal wages continued to grow in 2008 and were equal to USD 382 in December, up 24.4 percent from 2007. As in previous years the highest wages were registered in financial

YEREVAN 00000225 003.2 OF 004

services (USD 848), mining (USD 681) and real estate services (USD 385). Real average monthly wages were equal to USD 274, up 7.7 percent compared to 2007. The minimum wage set by law was equal to AMD 25,000 (USD 82).

INFLATION

¶15. (SBU) Inflation in 2008 was heavily influenced by developments in the global economy and the Russia-Georgia conflict in August. After sharp increases in food prices during the first three quarters of 2008, prices for many food and non-food products fell toward year-end. Inflation for 2008 was equal to 5.2 percent, compared to 6.6 percent in 2007. Government-protected monopolies for many imported items--including gasoline, wheat, sugar, vegetable oil--prevented consumers from receiving the full benefit of falling world commodity prices. Taking into consideration risks of deflation, the CBA decided to ease its monetary policy by gradually reducing the refinancing rate. (Note: When the CBA ended its forex intervention on March 3, it also increased the refinancing rate to 7.75 percent in order to tamp down inflationary pressures and discourage currency speculation. End Note).

¶16. (SBU) After a 20 percent increase in gasoline prices between January and August 2008--with a small spike during the August Russia-Georgia crisis that resulted in occasional disruptions in supplies--the price of gasoline fell by 14.3 percent in December compared to November and by 16.4 percent compared to December 2007. The diesel fuel price followed the same trend, growing by 31.5

percent in January-August and falling by 10.2 percent in December 2008 compared to December 2007. (Note: Prices continued to fall in the early part of 2009. They have increased again by about 15 percent since the March 3 devaluation of the AMD. End Note).

¶17. (SBU) The year-on-year producer price index in December was down by 12.3 percent, the price index in construction rose by 27 percent and freight forwarding by 7.8 percent. Average prices for imports grew by 7.3 percent and for exports fell by 14.5 percent.

2008 BUDGET TARGETS ACCOMPLISHED

¶18. (SBU) According to the preliminary data from the Ministry of Finance, total revenues collected were equal to AMD 759.2 billion (USD 2.5 billion) and expenses totaled AMD 803.4 billion (USD 2.6 billion). Budget deficit was equal to AMD 44.2 billion (USD 144.5 million), or 1.2 percent of GDP (the programmed budget deficit for 2008 was equal to 2.6 percent of GDP). Total tax revenues increased by 23.8 percent, with Tax/GDP ratio equal to 16.4 percent, compared to 15.4 percent in 2007. As in the previous years the share of indirect taxes in the total tax revenues was much higher compared to direct taxes, with VAT comprising 53 percent of total taxes.

FOREIGN TRADE DEFICIT EXPANDS

¶19. (SBU) Armenia's trade deficit increased by 58 percent to USD 3.4 billion, compared to USD 2.1 billion in 2007. During 2008 the total trade turnover grew by 24 percent, reaching USD 5.5 billion. Imports increased by 35 percent to USD 4.4 billion, while exports declined 7.2 percent to USD 1.07 billion. Imports grew mainly due to increasing imports of machinery and equipment (up 51.2 percent), vehicles (up 35.3 percent), base metals (21.1 percent), prepared food products (35.4 percent) and mining products (27.8 percent). The decline of the mining and diamond processing industries was primarily responsible for the drop in exports. Exports of base metals fell by 11.1 percent and precious stones and metals by 16.3 percent. With further declines expected in international metal prices, Armenian exports are expected to drop further in 2009. The Ministry of Finance expects exports to decline by 32.5 percent and imports by 13.9 percent in 2009.

¶20. (SBU) In 2008, Armenia's most important export partners were Russia (20.2 percent), Germany (17.2 percent), Netherlands (12.2 percent), Belgium (8.5 percent) and Georgia (7.7 percent). The leading import partners were Russia (14.7 percent), UAE (11.7 percent), USA (6.8 percent), Ukraine (5.8 percent), Iran (5.3 percent), Turkey (5 percent) and Georgia (4.1 percent). The most significant share in exports fell within base metals (32.4 percent), prepared food products (16.5 percent), mineral products (16.3 percent) and precious stones and metals (16.3 percent). Leading import product groups included mineral products, including natural gas (15 percent), machinery and equipment (14.6 percent), vehicles (13 percent), base metals and products made from them (9.4 percent).

YEREVAN 00000225 004.2 OF 004

FOREIGN DIRECT INVESTMENT

¶21. (SBU) Foreign investment increased by 71.4 percent in January-September 2008, compared to the same period of 2007, totaling USD 805.3 million, of which Foreign Direct Investment (FDI) was equal to USD 594.9 million. For the second consecutive year Russia was the leading investor into the Armenian economy, with USD 567.8 million (70.5 percent of total) in the first half of 2008, of which USD 431.8 million was FDI (72.6 percent of total), up by 4.3 times compared to the same period in 2007. Russian companies have taken over many of the largest companies in Armenia, including in the telecommunications, energy and transportation sectors. Argentina was the second largest source of FDI, with USD 76.9 million FDI, most of it in air transportation and agriculture. 28.3 percent of total investment went into the energy sector, 22.3

percent into telecommunications, and 16.9 percent into railways. Investment from the U.S. was equal to USD 21.9 million (2.7 percent of total), of which USD 13.4 million FDI (2.3 percent of total).

¶22. (SBU) As there are no statistics available yet for the second half of 2008, it difficult to judge how much the global financial crisis has affected investment flows to Armenia. However, it is likely that with many of the leading source countries--notably Russia--affected heavily by the global financial crisis, Armenia will face a considerable slowdown of foreign investment, which will in turn negatively affect economic growth.

PENNINGTON